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Marilyn A. Wethekam

Jordan M. Goodman

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## Emerging Tax Issues Connected to Cloud Usage

*Jordan M. Goodman and Marilyn A. Wethekam\**

JORDAN GOODMAN: Who has a tax background? Actually, Marilyn does not; she is a poli-sci major. My other partner in state and local tax is an English major. So you can do anything in life and become a tax person.

MARILYN WETHEKAM: Anybody here with an accounting background? Perfect.

JORDAN GOODMAN: During the time over the next forty-five minutes, we are going to sit here and make you tax people and at the end of the day you are going to say this is the coolest thing we can possibly do.

When I was six years old I did not know what it meant when I said I want to be a tax lawyer, and here I am a lot of years later doing what I love to do. With all due respect to the previous presentations, three letters were missing: T, A, X. Right? And this is the world we live in. This is why it is such a great place. But in Cloud computing and tax, if you want to carve out an area that is really a lot of fun and has lots of dollars in it, this is the area.

Has anybody bought anything on the Internet before? You are aware of the super information highway, the Internet, the whole thing, the World Wide Web? First I got to ask this: is anybody here from the Department of revenue or the Attorney General's office dealing with taxes? No one's hand went up. So we are free to disclose our personal buying habits on the Internet.

MARILYN WETHEKAM: He said buying habits and not viewing habits.

JORDAN GOODMAN: We are keeping it cleaner. Has anybody bought anything on the Internet? Come on. Everybody buys stuff on the Internet. Is everybody aware of this thing called Amazon.com? So we are an Amazon prime family. We get a package every day.

Another question—you probably did not realize there would be so many questions for you guys. Have all of you filed an Illinois income tax return? Have you earned money in Illinois and filed an income

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\* Attorneys at Horwood Marcus & Berk, Chartered

tax return? Have you noticed that line that has been there for five years right on the bottom? What does it say? Have you bought something from outside the state, brought it back in to the state and paid use tax on it? Remember there are no revenue agents and no one from the attorney general's office here. I get this question all the time: "Jordan, what should I put down?" So what is your answer? I always respond by asking, "What did you buy?" You got to have some facts. I bought a laptop. I bought a sweater. I downloaded some music.

MARILYN WETHEKAM: I bought shoes.

JORDAN GOODMAN: Many, many shoes. What did you buy? Did you pay tax on it?

Let's look around the room. When you buy something online who has to pay the tax? Now let's ask the opposite question. How many people have bought something online and not paid tax to the online provider? Okay, last question for a while. Who has reported it on their Illinois income tax return? We are all good. I asked everybody if they worked for the Department of Revenue or if they worked at the Attorney General's office, right? We are good. Who has reported that on their Illinois income tax return? Well I kind of have to because it is my job. So I do. That is a big problem. Why is it a big problem? First, why the Internet provider who is selling the stuff not collecting the tax? Why do some do and some do not?

There are a couple of provisions in the U.S. Constitution that affect state and local tax. There was a movie that had Joe Pesci in it, "With Honors," probably before some of you guys were born. Anyway, he ran into a guy from Boston. To graduate from Harvard you had to produce a paper. He left his paper behind. Joe Pesci got it. He held his papers, his honors papers, as ransom. So he would give him a page a day for room and board. They became friends over this. Joe Pesci showed up for a class, and they were talking about the constitution and saying how it is and how it has created a monarchy. Joe Pesci is the person who gets up and makes this impassioned speech about how great it is, the best document ever written in the history of man. And the reason why he said it—and I believe him and I agree with him—is because our founding fathers were so smart when they wrote that document that they knew that they would not capture every idea ever made so they wrote a document that can be interpreted by the people living at the time the issues come up. But give Ben Franklin his due and John Hancock and everybody their due. They did not know that Al Gore would invent the Internet in 2000, right? They did not know any of this, but they created a document that would allow us to inter-

pret the rights of the states to tax, which is same document they used two hundred years ago. And that is pretty cool.

As we mentioned earlier, there are two provisions in the U.S. constitution that affect state and local tax and what we as tax attorneys do for a living. Without getting in to the nitty gritty of it, the due process clause states that you cannot be deprived of life, liberty, or property—property meaning your money.<sup>1</sup> There is a requirement associated with that. The commerce clause says Congress shall have the power to regulate commerce among the several states and some other stuff.<sup>2</sup> Those two provisions are the two most powerful provisions in taxation. It says that a state can take my money if they give me due process of law; and if the feds do not like it, if congress does not like it, they can pass a law that prevents them from doing it.

Has anybody read the paper online about something like the marketplace fairness act, Main Street U.S.A.? It is a bill that has been bouncing around congress since 1992, actually. It talks about how congress may or may not get involved with the collection of sales tax at the state level.

MARILYN WETHEKAM: There have been congressional hearings on this. There was an article yesterday. The issue is really about whether you force an Internet provider to require them to collect use tax and sales tax on all the items that we all raised our hand that we purchased, and it would preempt the states from any type of statutes. Currently, congress has passed this law, and it has been a huge debate.

Anybody remember catalogs, you know, the paper kind?

JORDAN GOODMAN: Marilyn does. She used to work for Montgomery Wards. It is not based on her age. Her former employer had catalogs.

MARILYN WETHEKAM: The age joke will come later. Back in the 1960s there was a debate in congress as to whether they can require you to collect tax on items you purchased from a catalog. So this is an ongoing issue. When you get to the Cloud, it becomes much more complicated. I do not remember which presenter said statutes do not keep up with the Cloud. Patent and copyright laws are not consistent. Contract law is not consistent. If you think those laws are behind the times, trust me. The tax statutes and laws are so far behind the times. That is the issue.

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1. U.S. CONST. amend V (“[N]or shall any person . . . be deprived of life, liberty, or property, without due process of law . . .”); *id.* amend. XIV, § 1 (“[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . .”).

2. U.S. CONST. art. I, § 8.

JORDAN GOODMAN: The basic premise is why don't people collect tax on every sale? When you go to Marshall Field's—now Macy's—and you buy something, what happens? You pay a dollar for the pen. How much do you pay for it in the City of Chicago? Like \$1.10. The reason why they can do that is because they are physically present here. You are walking in to a store. The store is physically present. And for a long time prior to 1992 the requirements under due process and other laws were that you have to have some physical presence in the state in order to tax. If you are physically present in the state, you have an obligation to collect and remit tax.

So, when you walk in to Walgreens and you buy a pen, Walgreens is here. Walgreens is physically present in the state. And something else occurs. You get the pen. There is delivery of the pen to you. The transaction has been consummated in the state. So you got presence of the seller and you got delivery of the pen. Those two elements make it a taxable transaction in Illinois because Illinois has a law that says the transfer of all tangible personal property—tangible meaning you can touch it, feel it, measure it—in exchange for consideration is a taxable event. So what a lot of companies, both scrupulous and unscrupulous, say is that they are not physically located in Illinois. Going back to the days when we ordered things from catalogs, there were companies that sold pens and were located in Indiana. And they had a warehouse in Indiana, they sold pens from Indiana, and they would send you a catalog that you get every single day in the mail. So they are sending catalogs in the mail, and what happens? You pick up the phone or you go online and you order the pen, and they deliver it to you here in Illinois. Now you get a bunch of great pens. And a great pen is not something to be scoffed at. Very important. Good pens. Do they collect tax? Do they have to collect tax? Are they physically present in Illinois? No. Okay. So that is where the Illinois use tax comes in on your return because it is complimentary tax.

Illinois complicates everything. We have a retailer occupation tax, a service occupation tax, a service tax and a use tax. We have four taxes that accomplish the same thing. That's Illinois. We like bureaucracy. We are big about politics. We got a sales tax, and the other side of that is the use tax. The sale tax is imposed at the sale. If they are not physically present, you have an obligation to remit use tax to the state. Illinois makes it easy for you. You file a return on an annual basis. You used to have to file it quarterly or annually based upon your first in the state. That is easy. That is really easy because I got a pen. I know where I use it. The pen company in Indiana knew where they sent it.

So let's say they have a salesperson that comes into Illinois comes in just for a couple days a year to meet with hotels and colleges and law schools who need pens sitting on their desk when you come in so everybody has a pen. And they come in one day and ask if you would like to buy pens. Okay. Then they leave the state. They never cross the state line again. Never come back. Is that enough to be subjected to the tax in Illinois? Maybe. The Supreme Court says that is physical presence. Maybe it is *de minimus*. Maybe it is not enough. We can argue about that. How much contact do you have to have in that state? If you have a million dollars in sales overall and \$10,000 of sales in a particular state, are you subject to tax?

So we are dealing with this concept called Nexus. Am I subject to a state taxing jurisdiction? Let's get out of the catalog worlds and into the Internet worlds. As opposed to setting up a catalog company I set up a website here in Illinois. I got name plates. I got the best name plates in the business. I sell name plates. And I put up a website, and anybody in the world now could go on line and get some name plates. Somebody buys them in Indiana. Does the name plate company have to collect tax? Easy answer. Would you advise them to collect and remit tax? Who could tell me the local rate here in Chicago? 10 percent. I made that up. It is close. It is like ten and a quarter, ten and seven-eighths. If you are selling food in the metropolitan district, it is up to like eleven percent. What is the combined rate in your neighborhood? Nine? Wherever you live. Do you know what it is? Of course not. It is one of those complex things. We just had a case go to the Illinois Supreme Court dealing with local taxes. It is all different. Very difficult thing to do. So now if I am on the Internet, I do not have to do that unless I have something else going on in the state. The states got angry about that. They claim the reason they are pushing for this federal bill is that they are losing 10, 15, 20 billion dollars a year because all of you do not report your purchases on your income tax returns.

Now we all know Illinois is in pretty crappy shape.

MARILYN WETHEKAM: Financially.

JORDAN GOODMAN: Financially and pothole-wise. I read something in the paper about a cop that pulled someone over and asked are you drunk, were you drinking, and the lady said I'm just avoiding the potholes. She was driving around like crazy. So lots of revenue potentially lost.

So there is this case called *Quill*, a North Dakota case. North Dakota is very aggressive on out-of-state companies in collecting their local tax because there are only 200,000 people in North Dakota.

That is why there is only one store, and it is a Cabell's. Unless you hunt or fish there is nothing there for you. Everybody is going in there. Everybody is shipping in stuff. No one is collecting tax. They go after Quill, which is an Illinois-based company that sells office supplies; and the question is are they subject to tax, should they collect it. A lot of companies went in there. The question was are they subject to tax or are they not subject to tax. There is litigation that went on. There was sneaky stuff that was done. The circuit judge said no. The North Dakota Supreme Court in 1992 reversed the circuit court and then did something really dumb. The world is a very sophisticated place. We got catalogs. We got computers. We got the ability to compute all this stuff, and they said, Quill, you are sending catalogs into the state. The phrase was, "you are purposefully availing yourself of the marketplace." You then should have an economic presence because you are making sales and now you are subject to tax in North Dakota. And that is what the North Dakota Supreme Court held, and then they went one step further, which you should never, ever, ever do. They said to the U.S. Supreme Court—because this case is destined for the Supreme Court—we defy the U.S. Supreme Court to find differently.

Okay. Anybody remember Jim Croce? He made a song called "Bad Bad Leroy Brown." So the line in Bad Bad Leroy Brown "you don't pull on superman's cape, you don't spit in the wind." You do not defy the U.S. Supreme Court to find differently because you know what they are going to do. They are going to find differently. And they reversed the North Dakota Supreme Court, and they said we are going to kind of give you a half victory. Under due process, purposefully sending catalogs into the state is enough to subject you to the tax. Regular and systematic solicitation. That is enough. It goes beyond due process protection. However, under the commerce clause, you need physical presence. You need something, a body, somebody selling, somebody doing something on your behalf in the state. That is why we are at the feds right now trying to figure out this for a federal law. If it is the commerce clause, congress has the availability to regulate for the states. If they make it legit, it is good.

MARILYN WETHEKAM: So twenty-two years years later—if my math is right (I am a poli-sci major, but I can add and subtract)—and beyond the catalog stage and what we have been talking about today about the Cloud and now we are at the next topic: when you contract with a provider, be it Amazon or whomever, what are you contracting for? We may think that sales taxes aren't tangible personal property,

but what the state says is another thing. What are you contracting for?

JORDAN GOODMAN: Let's talk about physical presence for a second. If I have inventory in a warehouse in another state, is that physical presence? Sure. I got inventory. I got property located there. And to Marilyn's point, if I upload something in to the Cloud, what gets uploaded? Electrons. Okay. Digits of information get uploaded. I got electrons. And what is the equivalent in a warehouse? A server? That server has my physical property, electrons, in that state. Is that enough to subject you to tax?

MARILYN WETHEKAM: First of all, I think the bigger question is what state. Where is it? Sales tax, use tax, I am going to use those interchangeably because to me they are the same. It is based on where the location of the transaction took place. Where did that transaction take place?

JORDAN GOODMAN: Do you have in your agreements that you talked about, all the things you covered—which is wonderful, I got thousands of notes. I love it.

When you upload something in to the Cloud where does it go? Do you have an agreement they could only use the server in North Carolina? Of course not. I do not care where it goes. Is it secure? Can I get it back? What happens if you guys go out of business? What if you merge or just go away? What kind of security do I have? But you now have property somewhere . . .

MARILYN WETHEKAM: And it could be on some oil platform out in the North Sea. So here comes the problem. In my example, I went down to Macy's and bought shoes. In Jordan's example, it was a pen. With any kind of data uploaded in to the Cloud you do not really have a true location, but what you may be staring at is a very large tax bill.

JORDAN GOODMAN: Think about this: you have a product that you are selling on the Internet and we say that you have physical presence in North Carolina even though you do not have anybody there—you don't have any relatives there, you do not even like North Carolina, no one is allowed to go to North Carolina. Nonetheless, you utilize a Cloud service and that Cloud service has servers located in North Carolina or Virginia, a very popular state for Cloud space, do you now create an access? Are you now subject to taxes in those states? And if you are, how do you even know?

So what happens is, North Carolina says, "Hey, you sold one million pens into North Carolina, did you collect tax?" You go, "Whoa, whoa, back off. I am not present there." They go, "No, no, that Cloud



service provider that you were using has got a big facility here and we cracked open one of their servers and we saw your electrons, your digits, we know they are yours and they are here in North Carolina. You have physical presence in the state.” Therefore, they have jurisdiction to impose tax on you. By the way, you did not collect any taxes from your customer. So you know what happens? It comes out of your pocket. Is anybody familiar with the statute of limitation, if you do not file your taxes within a certain period of time? Well, there is no statute of limitations for reporting taxes if you do not file a return in that state. And you never file a return in that state because you did not know that you were subject to tax there. Okay. That is the liability we are talking about.

MARILYN WETHEKAM: Unlimited liability, you as someone utilizing the service and selling tangible property, you are utilizing this. Let’s do the flipside. That service provider, Amazon or an Amazon-type service provider is providing you a service. There are a significant number of states that tax services. So now you are the provider. Do you have in your contract whether there is a monthly fee for this? If I put something up in the Cloud, I pay a monthly fee. Do you have in your contract that I will collect tax from you at 10 percent, eight and a quarter, whatever the appropriate rate is? And if the answer is no—you guys have both done contract litigation. How successful are you going back five, ten years later in trying to collect?

So now it is an out-of-pocket expense. And it is just not the tax. There are penalties and interest on top of that. But when we looked—you know, here is the contract and here is what—your due diligence that should be part of what you do, and there is some sort of protection for the Amazon versions of the world to protect themselves in case they have to collect tax.

I will also tell you there are some states that have looked at this from a tax perspective and have come up with some theories as to whether it is taxable or not. They may not follow the trademark—Massachusetts will tax everything. They have gone to look at it. Illinois has not gone to look at it.

But here is a real-life example. The City of Chicago has something called the non-title personal property lease tax. Say that ten times. And it has been around for a very long time. And what I had to explain to one of our youngest associates is your picture of what the Lexis machine looked like—that Lexis you did not get off the Internet. When I was in law school you had a dedicated machine for it. There is a very old case if you extract data and it comes off a piece of paper that is subject to non-title lease tax in Chicago. Fast forward to

today. You get a subscription, RIA, Dow Jones, or Dun and Bradstreet, and you go through an Internet portal to get that information. And in the case of Dun and Bradstreet, it changes a zillion times a day. Have you leased something? Under this tax the City of Chicago right now is wrestling with this and is auditing a number of people. It is a significant tax liability. That tax is seven and a quarter. That is another example of you are extracting information from somebody's database that very well may be in the Cloud—is it a taxable transaction? When you look at a contract for one of these services, does it say we will remit tax?

JORDAN GOODMAN: A lot of them do not even talk about tax, which is on the side that is really, really good for Marilyn and I. The states are great about that. If they want to collect money, they go after everybody and let you guys figure it out. They say it was a taxable event, someone has got to pay. There is a sales tax due by the seller or a use tax due by the buyer. We do not care. You guys figure it out. We will wait until you do, and the interest will continue to accrue while you guys decide who should pay us.

MARILYN WETHEKAM: In the example of the Chicago lease tax, a lot of these old subscription agreements, because they haven't been written for a number of years, use the term "lease." It is not a lease. It is a subscription. You are getting on someone's website to obtain their proprietary information. It is not a lease. Take that out of your contract because auditors only read what they want to read and when the word "lease" jumps off the page at them they are never going to read the rest of it.

JORDAN GOODMAN: There was this idea that if you used LexisNexis services in the City of Chicago—back in our generation you used to have a hard line machine from your machine to the database located outside of Illinois, and Chicago was successful in arguing that Lexis' jurisdiction was in Illinois because they had that hard line. No one has a hard line to LexisNexis. It is a website. By drawing their information to your laptop or to your phone now is that enough to draw them in to places where they did not think they were subject to tax before?

MARILYN WETHEKAM: Or subject to one of these specialized taxes.

JORDAN GOODMAN: The jurisdiction being subject to tax. You have been on the Internet. You are searching around, and let's say you want to get a new dog. Everybody loves a dog. You got big dogs, little dogs. You are not sure which one you want, but you want one. You got allergies or something like that and/or you have an apart-

ment. So you want a small dog that's hypoallergenic, and Google comes up with a bunch of stuff. And so you look it over and on the side over here there is something flashing and it gets your attention, and it goes if you want to know about dogs click here. And you click on it, and all of a sudden you're at Amazon.

Amazon has these agreements with every website saying, if you want to know about that, click here. That is a hypertext link. And they say, hey, if you want to buy a book about small hypoallergenic dogs here's a whole bunch of them. You say, yeah, I want to do some research, I want to think about it. So you click on that and get the book. And they send it to you, and they don't collect tax. Of course not.

What also happens is that website that Google sent you to with the hypertext link, it gets paid a commission for referring you to Amazon. They have acted as an agent on your behalf because it is as if they said, hey, you want a book, come follow me; and you followed them, and Amazon knows that they're the ones that sent you to the Amazon site and they get some percentage of the sale as commission for soliciting your sale. Where are those people located? New York was the first state out of the box to pass something called the Amazon.com law.

MARILYN WETHEKAM: It is never good to have a statute named after you.

JORDAN GOODMAN: Never good. It says, Amazon, we know you hate New York, you'll never be in New York, but we do not care because if you have a resident to be defined later on who has a website in New York and it has an Amazon link on it and they refer you back to your site and they buy something, you pay that resident commission, you are subject to tax because you have an employee, an agent, a representative in New York who is soliciting sales on your behalf. Now you are subject to tax in New York, and Amazon is sitting on the West Coast saying we hate the East Coast, we do not ever want to go there; and they are subject to tax now in New York.

MARILYN WETHEKAM: And there is a petition pending.

JORDAN GOODMAN: It is not about where they intend to go. It is where other people take them. They have to collect the tax. Big liability. That is the first thing, are you subject to tax in all the states by going up in the Cloud, and how do you limit that?

MARILYN WETHEKAM: It makes a difference what you are putting up in the Cloud. JORDAN GOODMAN: If somebody else is extracting the data, it could give you a taxable transaction in a state you never dreamed of.

If you are merely storing information in the Cloud, you are a law firm and you are keeping all your files in the Cloud, from a law firm perspective you're probably okay. What you may be doing is utilizing a taxable service and on the Cloud side that has an issue and it's not collecting a tax, they could be staring at a very significant liability.

So we talked about the ability of states to impose a tax, which is a huge problem. Now the next question is what can they impose it on? I will tell you, every state except for five—and there are—it is NOMAD. Those five states are New Hampshire, Oregon, Maine, Alaska, and Delaware. They do not have sales tax. Everyone else has a sales tax. So remember NOMAD as the five states that you want to go buy stuff in. No sales taxes. Every state has a sales tax other than those five. Everyone says initially it is the transfer of tangible personal property in exchange for consideration. TPP, okay. That is how it all started. States need money. They expand the base, and they go after services.

So let me ask you a question that is kind of a TPP kind of a thing, this thing called software. If I went back to Radio Shack or to the Apple store and I wanted to buy some software and they give you a nice little box with a lot of stuff, you know, like a lot of stuff that fills it up and all you get is a disk. And you get this disk and you buy it at the Apple store. Do they charge you tax? Absolutely, positively, yes. Why? Because you are getting something tangible. What if you went online—everybody is familiar with iTunes. You probably do not even remember CDs. Do you guys know what a CD is—yeah, you do. If you went and bought a CD at the record store, that is a taxable event. If you downloaded an iTune, is that taxable? I do not know. Is it tangible? There is a whole section about this. Is it fair that if I buy the hard copy of something it is taxable, but if I buy the electrons it is not. And California is really a pretty unique state in a lot of ways. In state taxation we call it the mother, the mother of state taxation because all whacky ideas come out of California. California says if I go to the local Apple store and I buy something tangible, if I download it electronically, no tax. At the end of the day you end up with the exact same products. You got the song that you wanted. You got the movie. You got the book that you wanted, but they are distinguishing between those because they say one is a service, it is not TPP, and one is. But that is California. The question is what is software. When you are going up in the Cloud and you are getting shared space for Word Perfect or for . . .

MARILYN WETHEKAM: Microsoft 365.

JORDAN GOODMAN: I am still in 112.

MARILYN WETHEKAM: Microsoft 365 is Microsoft's Cloud version. It has a lot to do with how compatible your computers are.

JORDAN GOODMAN: So when you download software is that TPP or not? What else do you get? Anybody got an E-reader? Anybody read a book online? Anybody read a book on their I-pad? Barnes & Noble still exist? Which is one still around—Barnes & Noble. You go to Barnes & Noble. They charge you for a book. You get it for your E-reader and download it. You pay a tax. Do you say I bought a book on line for the Illinois department of revenue? Do you pay tax on it? In Illinois, absolutely not. Don't do it. Tell them Marilyn Wethekam said I do not have to do it. In some states that going to be taxable.

There is this communist movement among a number of states that adopted something called the streamline sales tax where they said, hey, we are going to do it all together and we are all going to agree on one set of rules. And there is something like twenty-six states, and they all agree until they disagree to do it all together, taxing everything all the same way. It is anti-American in my mind, but that is kind of what they have done, and they have been fairly successful about doing it that way.

First thing, am I subject to tax? Second thing, is what I am selling taxable? Okay. The third thing—and this is really the most important one—is if I am subject to tax and it is taxable, where did I sell it? So when you go on line and you are home in your apartment and you go download some software, you know where you are—I am assuming you know where you are. You know, this is after you are at the bars or something like that and you may not know where you are but you kind of know where you are, and you download it.

I remember we used to drive every year—my wife's family is from Tennessee. We used to drive to Tennessee. It is about an eleven-hour drive to East Tennessee. So I am driving in the mini van—I love my mini van. We got some games from Nintendo that you can play on the console in the mini van, and my kids had mastered those games about two hours in. So now you got nine hours to go. What would you do? Stop and download some more games? So I used to be in my apartment. Now, I now somewhere in Ohio or Kentucky or Indiana, and I'm downloading games. Does Nintendo know where I am to charge me tax on this taxable product? If they collected tax, who are they going to pay it to? Do the companies know? There is an IP address to every computer, right? So they know the computer that was used. And I am not taking my desktop with me. I am taking my laptop with me so they can play it. So that laptop is being mobile. So has any-

body ever downloaded something when they are not at home, on their laptop or on their phone? So I know I got jurisdiction. I admitted it. I am everywhere. And I know what I'm selling is taxable everywhere and I am going to collect the tax from you. And I do collect the tax from you. Who do I give it to? Exactly. You got a puzzled look. Who do I give it to?

MARILYN WETHEKAM: And you cannot keep it. That is a class something felony.

JORDAN GOODMAN: That is called stealing. We have to advise you that that's unethical. So you got to turn that over to the state. Even with a short-term loan it's not a good idea. It is very bad. We have represented a couple people like that. But where do you report it?

MARILYN WETHEKAM: If you have a Cloud service and you represent them, it may or may be taxable. In essence where the issues arise, assuming it is, where are you accessing it, where are you pulling the data from ad in the tax world it is how do you source it. And you could be generous and give it all to one state and you are good that way until the other six or eight come walking in the door and ask you for their share. And with all due respect to drafting the contracts, this is stuff that needs to be put in. This type of concept needs to be drafted in to a contract.

JORDAN GOODMAN: Who is responsible for it?

MARILYN WETHEKAM: Who will reimburse whom if in fact there's a tax liability? Who will produce records if in fact you're audited? Where are those records? How long do you have to keep those records?

JORDAN GOODMAN: So just to give you some answers—and there are answers out there. Streamline—and I joke about it, but they did come up with some concepts. This is where in the tax world reality is disassociated with what you do—and we have a simple rule. If you do not know how to do it, make something up. That is kind of what streamline has done with this kind of uniform rule that twenty-six states has adopted. They made stuff up. They say if you do not know where to send it, where did they order it from, did they use a credit card, what's the billing address of the credit card, is that where you are. No. The reality is separate from fiction. They create it to allow you to function in the world because the credit card companies do not like giving up their address. If you ask online where are you, I do not know, I am on a highway. It is dark, I am on interstate something. So they could ask you. It could be where your credit card that you use to buy it is located. It could be where they are located, right? Because

they receive the order somewhere. If they have one server in one state, they know where that server is and they can collect the tax and remit it all to that one state. They have no other information. So there are a number of options available, and streamline says if you know where they are located, do that. If you know where they said they are, do that. If they have a billing address, do that. A shipping address, do that.

MARILYN WETHEKAM: Where the contract was entered into.

JORDAN GOODMAN: If you know any of those things, do it where they are located. So they are giving you at least an option to do it. It has nothing to do with the reality of the transaction.

MARILYN WETHEKAM: And the current federal debate that is going on is making it simple. They would like just to do it from the point of origin. So the state of origin is the state that is going to recoup all the revenue.

I am guessing there are at least forty-five others that are not going to be happy with that result, but that's one simple way to do it. The point being, here, once you get out of selling—walking down the block to Macy's at the corner on State and pick something off the shelf, once you get passed that and get in to this kind of Cloud nebulous kind of thing, we do not know where it is and it becomes very complicated and difficult to determine if you even have a taxable transaction. If you have a taxable transaction, you are required to collect taxes on it. The bigger issue is that, in the end, if you do this incorrectly you are facing significant liability.

JORDAN GOODMAN: States come up with these terms that they use in their world, and in our world we do not know what they mean but they sounds really good. So a lot of states have adopted something, the product that you bought, the software that you downloaded, the electrons that you now have on your computer, the Cloud that you are using is taxable in the state of first use.

Well, what does that mean? In the context of pushing or pulling, am I pulling it off the server or are they pushing it out to me? Remember we started this discussion with the delivery of a pen at Walgreens. We had delivery. We had use. Use is control. That is where I first have control over this, either physical possession or control. First use of the software. First use of the electrons. Where did that occur? I think they created a phrase that does not have much meaning because I can argue a whole bunch of different things and I do not even know—but we are going to bring in experts to talk about whose electrons are they.

I get something, is it delivered at the website wherever that server is located or is it delivered electronically to me to my computer? I really do not know the answer to that, and there's some really smart people trying to help me figure that out.

MARILYN WETHEKAM: We have been talking about the sales tax liability, but for those of you who represent a Cloud provider or a law firm does that type of thing, what you are doing by providing a Cloud service in a state does that give the state jurisdiction to tax you? Assuming it does, if it does, you're supposed to assign a portion of your income to that state. How do you do it? You do it based on receipts. Where did you receive those receipts? If you are on Amazon, in Seattle, Washington but you received those receipts in New York, that is another issue that should be addressed, I think, in a contract.

Now the negotiation to that contract just actually could be comical. So there is another side to this, and an income tax liability can be large—if you are talking about an Amazon-type company with a significant amount of income, it could be as large or larger than your income tax liability.

JORDAN GOODMAN: What is the key thing that you have to remember out of all this? NOMAD. No taxes in NOMAD. All right.



